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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 303

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, PETITIONER

vs.

AMERICAN DENTAL CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 14, 1942
CERTIORARI GRANTED OCTOBER 12, 1942

**In the
United States Circuit Court of Appeals
For the Seventh Circuit**

No. 7847

AMERICAN DENTAL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**Petition for Review of Decision of the United States Board
of Tax Appeals.**

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1	American Dental Company, <i>Petitioner,</i>	} Docket No. 102977.
	<i>vs.</i>	
	Commissioner of Internal Revenue, <i>Respondent.</i>	

Appearances:

For Taxpayer: Wm. E. Hughes, Esq.

For Comm'r: Jonas M. Smith, Esq.

DOCKET ENTRIES.

1940

May 27—Petition received and filed. Taxpayer notified.
(Fee paid.)

May 27—Copy of petition served on General Counsel.

July 19—Answer filed by General Counsel.

July 19—Request for hearing in Chicago, Ill., filed by General Counsel.

July 23—Notice issued placing proceeding on Chicago, Ill., Calendar. Answer and request served.

Oct. 8—Hearing set Dec. 2, 1940 in Chicago, Ill.

Dec. 2—Hearing had before Mr. Murdock on motion of petitioner to file amended petition, granted. Amended petition filed. Copy served. Application for subpoena filed.

Dec. 2—Subpoena duces tecum to Mallers Bldg. Trust, issued.

Dec. 2—Subpoena duces tecum to American Dental Co., issued.

Dec. 4—Hearing had before Mr. Murdock on merits. Submitted. Answer to amended petition filed, copy served. Briefs due as per rules.

Dec. 11—Transcript of hearing 12/4/40 filed.

1941

Jan. 16—Brief filed by taxpayer.

Jan. 18—Brief filed by General Counsel.

Apr. 3—Motion to amend brief filed by taxpayer. 4/3/41 granted.

Apr. 16—Copy of brief served on General Counsel.

May 7—Findings of fact and opinion rendered, Murdock, Div. 3. Decision will be entered for the respondent. 5/7/41 copy served.

May 7—Decision entered, Murdock, Div. 3.

Petition.

June 2—Motion for rehearing and in the event of its denial for review by the Full Board filed by taxpayer.

June 3—Order denying review by the Board but the motion insofar as it asks for a rehearing is referred to Div. 3 (Murdoch) for action, entered.

June 6—Order that motion of petition insofar as it asks for rehearing is denied, entered.

Aug. 14—Petition for review by United States Circuit Court of Appeals, 7th Circuit, and statement of points filed by taxpayer.

Aug. 14—Praecipe for record filed by taxpayer—with proof of service thereon.

2 Aug. 16—Proof of service of petition for review and statement of points filed.

Aug. 29—Agreed statement of evidence filed.

Sept. 22—Motion for 30 day extension to prepare and transmit record filed by taxpayer.

Sept. 23—Order enlarging time to Nov. 12, 1941 to prepare and transmit the record, entered.

Sept. 29—Copies of statement of evidence (agreed) filed 8/29/41 received.

Filed 3
May 27,
1940.

UNITED STATES BOARD OF TAX APPEALS.

American Dental Company,	}	Docket No. 102977.
<i>Petitioner,</i>		
<i>vs.</i>		
Commissioner of Internal Revenue,		
<i>Respondent.</i>		

PETITION.

Filed May 27, 1940.

The above-named petitioner hereby petitions for a redemption of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SN-IT-3) dated May 21, 1940, and as a basis of its proceeding alleges as follows:

(1) The petitioner is a corporation with its principal office at 5 South Wabash Avenue, Chicago, Illinois. The return for the period here involved was filed with the collector for the First district of Illinois.

(2) The notice of deficiency (a copy of which is attached

and marked Exhibit A) was mailed to the petitioner on May 21, 1940.

(3) The taxes in controversy are income and profits taxes for the calendar year 1937 and in the amount of \$6744.08.

4 (4) The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Respondent erred in adding to petitioner's 1937 income the sum of \$19,234.21 for an alleged "cancellation of indebtedness."

(5) The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner denies that the said sum of \$19,234.21 constituted indebtedness due from petitioner to others. The alleged forgiven indebtedness consisted of interest which petitioner's bookkeeper by mistake charged on its books on open accounts due from petitioner to others. There was no agreement between petitioner and its debtors that interest should be paid on these accounts and petitioner was subsequently advised that it was not legally obligated to pay interest and so advised its debtors who took the same view. Hence petitioner denies that any indebtedness was cancelled because said interest was never legally due and owing. Petitioner received very little benefit (in comparison with the deficiency herein asserted) from the deduction of this interest because its losses in some of the years in which this interest was deducted were so large that had it not been deducted petitioner would have had no taxable income.

(b) However, petitioner asserts that if any indebtedness was cancelled such cancellation was without consideration and hence was a gift to petitioner and is expressly excluded from taxable income by the provisions of the Revenue Act expressly excluding gifts therefrom.

5 Wherefore, the petitioner prays that this Board may hear the proceeding and disallow the deficiency.

(signed) John E. Hughes,
Counsel for Petitioner;
First National Bank Bldg.,
Chicago, Illinois.

State of Illinois }
County of Cook } ss.

William H. Schroll being first duly sworn, deposes and says that he is the President of the petitioner above named and that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition or had the same read to him and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

(signed) Wm. H. Schroll.

Subscribed and Sworn to before me this 23 day of May, A. D. 1940.

(signed) Mabel Grant,

(Notarial Seal)

Notary Public.

Com. Exp. 8/28/42.

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SN-IT-3

"EXHIBIT A"

TREASURY DEPARTMENT.

Internal Revenue Service.

Chicago, Illinois.

May 21, 1940.

Internal Revenue Agent in Charge
Chicago Division
Room 1100, 105 West Adams Street
American Dental Company,
5 So. Wabash Avenue,
Chicago, Illinois.

Sirs:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1937 discloses a deficiency of \$6,339.77 and that the determination of your excess-profits tax liability for the year mentioned discloses a deficiency of \$404.31 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Chicago, Illinois for the attention of SN:IT. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Guy T. Helvering,

Commissioner,

By O. W. Olson,

Internal Revenue Agent.

Enclosures:

Statement.

Form of waiver.

Form 272M.

MA:ME

Statement.

SN:IT

American Dental Company,

5 So. Wabash Avenue,

Chicago, Illinois.

Tax liability for the Taxable Year Ended December 31, 1937.

	Liability	Assessed	Deficiency
Income Tax	\$11,019.51	\$ 4,679.74	\$ 6,339.77
Excess-profits Tax	404.31	None	404.31
	<u>\$11,423.82</u>	<u>\$ 4,679.74</u>	<u>\$ 6,744.08</u>

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the report of examination dated January 31, 1939; to your protest dated April 27, 1939; and to the statements made

at the conferences held on May 16, 1939 and August 18, 1939.

If you do not acquiesce in all of the adjustments making up the deficiencies indicated, but desire to stop the accumulation of interest on that part of the deficiencies resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiencies you desire to have assessed at once. The execution of the form for the agreed portion of the deficiencies will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiencies.

Adjustments to Net Income.

Net income as disclosed by return		\$18,292.39
Unallowable deductions and additional income		
(a) Taxes	\$ 177.85	
(b) Interest expense	454.28	
(c) Cancellation of indebtedness	19,234.21	19,866.34
Net income adjusted		\$38,158.73

8

Explanation of Adjustments.

(a) Taxes, deducted in your return in the amount of \$4,936.14, have been reduced to \$4,758.29, the amount which accrued during the taxable year and deductible under the provisions of section 23(c) of the Revenue Act of 1936.

(b) Interest expense has been disallowed to the extent of \$454.28, since this amount was forgiven prior to the end of the taxable year and included in the amount of \$25,219.65 charged to notes and accounts payable and credited to surplus during the year.

(c) Income has been increased by the sum of \$19,234.21, representing that part of the amount charged to accounts and notes payable and credited to surplus within the year, in accordance with an agreement reached with your creditors for the cancellation or reduction of your indebtedness, which consists of items deducted or otherwise taken into account in computing your net income for years prior to 1937 and for which you have received a tax benefit.

Computation of Tax.

Excess-Profits Tax:

Taxable net income	\$38,158.73
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Less:

10% of \$314,201.91 value of capital stock as declared in your capital stock tax return for year ended June 30, 1937	31,420.19
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Net income subject to excess-profits tax	\$ 6,738.54
5% of declared value of capital stock	\$15,710.10

Balance	\$ None
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Excess-profits tax:	
6% of \$6,738.54	\$ 404.31

Total excess-profits tax	\$ 404.31
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9 Excess-profits tax assessed:

Original March 1938 list, account No. 403360	None
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Deficiency of excess-profits tax	\$ 404.31
Income Tax	

Normal Tax:

Taxable net income	\$38,158.73
--------------------	-------------

Less:

Excess-profits tax (accrued)	404.31
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Net Income for normal-tax computation	\$37,754.42
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Less:

Interest on U. S. obligations	None
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Normal tax net income	\$37,754.42
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8% of \$ 2,000.00 (Over 0 to \$ 2,000)	\$ 160.00
--	-----------

11% of \$13,000.00 (Over \$ 2,000 to \$15,000)	1,430.00
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13% of \$22,754.42 (Over \$15,000 to \$40,000)	2,958.07
--	----------

Total normal tax	\$ 4,548.07
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Surtax on Undistributed Profits:

Taxable net income	\$38,158.73
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Less:

Excess-profits tax	\$ 404.31
Normal Tax	4,548.07
	4,952.38

Adjusted net income	\$33,206.35
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Less:

Dividends paid credit

None

Undistributed net income

\$33,206.35

10 7% of \$ 5,000.00

\$ 350.00

12% of \$ 3,320.64

398.48

17% of \$ 6,641.27

1,129.02

22% of \$ 6,641.27

1,461.08

27% of \$11,603.17

3,132.86

Total surtax

\$ 6,471.44

Normal tax

4,548.07

Total income tax (normal tax and surtax)

\$11,019.51

Less:

Foreign tax credit

None

Balance of tax assessable

\$11,019.51

Income tax assessed (normal tax and surtax):

Original March 1938 list, account No. 403360

4,679.74

Deficiency of income tax

\$ 6,339.77

Filed
July 19,
1940.

UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—102977) • •

ANSWER TO PETITION.

Filed July 19, 1940.

Comes now the Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled cause, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits the amounts in controversy are income and excess-profits taxes for the year 1937. Denies all other allegations contained in paragraph 3 of the petition.

4. Denies each and every allegation of error contained in paragraph 4 and its subdivision of the petition.

5 (a) and (b).. Denies the allegations contained in paragraph 5 and its subdivisions of the petition.

6. Denies generally and specifically each and every alle-

gation contained in the petition not hereinabove admitted, qualified or denied.

Wherefore it is prayed that the Board redetermine the correct amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, viz., income tax for the taxable year ended December 31, 1937, \$6,339.77; excess-profits tax for the taxable year ended December 31, 1937, \$404.31.

(Signed) J. P. Wenchel,

FRS.

J. P. Wenchel,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

F. R. Shearer,

Division Counsel.

Jonas M. Smith,

*Special Attorney, Bureau of
Internal Revenue.*

13 UNITED STATES BOARD OF TAX APPEALS.

(Caption—102977)

Filed
Dec. 2,
1940.

AMENDED PETITION.

Filed Dec. 2, 1940.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SN-IT-3) dated May 21, 1940, and as a basis of its proceedings alleges as follows:

(1) The petitioner is a corporation with its principal office at 5 South Wabash Avenue, Chicago, Illinois. The return for the period here involved was filed with the collector for the First district of Illinois.

(2) The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on May 21, 1940.

(3) The taxes in controversy are income and profits taxes for the calendar year 1937 and in the amount of \$6744.08.

14 (4) The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

(a) Respondent erred in adding to petitioner's 1937 income the sum of \$19,234.21 for an alleged "cancellation of indebtedness."

(5) The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Petitioner alleges that if any interest on indebtedness was forgiven such forgiveness was necessarily a gift and as such is expressly exempt from income tax by the Revenue Act. A promise to pay a smaller sum in consideration of a release from liability to pay a larger sum is not an enforceable contract. In such a case a creditor may sue for the balance at any time. Unless the creditor has made a gift no indebtedness is or can be forgiven under such circumstances.

(b) Petitioner alleges that the sums of \$16,427.81 and \$519.85 of said \$19,234.21 constituted interest on accounts due for merchandise. Petitioner never received any money at any time for said interest and was not enriched either by this interest or the rent mentioned herein except to the extent of such benefit as it secured by deducting this sum from its income tax returns in former years, the amount of such benefit being much smaller and grossly disproportionate to the amount of tax claimed from it herein. It has offered to pay respondent in settlement of this case the amount of 15 tax saved it in former years by said deductions but respondent has refused this offer.

(c) Petitioner alleges its creditors agreed prior to 1937 it would not have to pay said interest.

(d) The balance of the alleged forgiveness constituted \$7,798.99 rent. Petitioner owed its landlord \$15,298.99 rent at the end of 1933. In December 1933, its landlord agreed that the landlord would accept \$7,500 in full payment of said \$15,298.99. Said \$7,798.99 was forgiven prior to the year 1937 involved in this appeal.

(e) The fair market value of petitioner's assets did not equal the amount of its liabilities at the time in 1937 respondent claims said indebtedness was forgiven.

Wherefore, the petitioner prays that this Board may hear the proceeding and disallow the deficiency.

Wm. E. Hughes,

Counsel for Petitioner,

First National Bank Bldg.,
Chicago, Illinois.

State of Illinois, }
County of Cook. } ss.

William H. Schroll being first duly sworn, deposes and says that he is the President of the petitioner above named and that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition or had the same read to him and is familiar with the statements 16 contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

William H. Schroll.

Subscribed And Sworn to before me this 2nd day of December, A. D. 1940.

Isaac M. Edson,
Notary Public.

(Seal)

For Ex. "A", see Ex. "A" attached to Petition.

17 UNITED STATES BOARD OF TAX APPEALS.
* * (Caption—102977) * *

Filed
Dec. 4,
1940.

ANSWER TO AMENDED PETITION.

Filed Dec. 4, 1940.

Comes now the Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed in the above-entitled cause, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the amended petition.

3. Admits the amounts in controversy are income and excess-profits taxes for the year 1937. Denies all other allegations contained in paragraph 3 of the amended petition.

4. Denies each and every allegation of error contained in paragraph 4 and its subdivision of the amended petition.

5 (a). Denies the allegations contained in subparagraph (a) of paragraph 5 of the amended petition.

5 (b). Admits petitioner received benefit to the extent of \$19,234.21 by deducting this sum from its income tax returns in former years. Denies all other allegations con-

tained in subparagraph (b) of paragraph 5 of the amended petition.

5 (c). Denies the allegations contained in subparagraph (c) of paragraph 5 of the amended petition.

18 5 (d). Admits \$7,798.99 of the forgiveness constituted rent. Denies all other allegations contained in subparagraph (d) of paragraph 5 of the amended petition.

5 (e). Denies the allegations contained in subparagraph (e) of paragraph 5 of the amended petition.

6. Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore admitted, qualified or denied.

Wherefore it is prayed that the Board redetermine the correct amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, viz., income tax for the taxable year ended December 31, 1937, \$6,339.77; excess-profits tax for the taxable year ended December 31, 1937, \$404.31.

(Signed) J. P. Wenchel, D. A. I.

J. P. Wenchel,

*Chief Counsel, Bureau of
Internal Revenue.*

Of Counsel:

F. R. Shearer,

Division Counsel.

Jonas M. Smith,

*Special Attorney, Bureau of
Internal Revenue.*

27 IN THE UNITED STATES CIRCUIT COURT OF APPEALS,
For the Seventh Circuit.

American Dental Company, <i>Petitioner,</i>	}	B. T. A. Docket No. 102977.
<i>vs.</i>		
Commissioner of Internal Revenue, <i>Respondent.</i>		

STATEMENT OF THE EVIDENCE.

Filed Aug. 24, 1941.

WILLIAM H. SCHROLL, 830 Monroe Avenue, River Forest being duly sworn testified as follows:

I have been president of petitioner since it was organized in 1920. That is my sole business and has been since petitioner was organized. Petitioner is in the dental laboratory business. I am there approximately every business day and am thoroughly familiar with its affairs. I conducted the negotiations for the forgiveness of debt in issue here. The first conversation was in the office of the Mallers Building the 19th of December, 1933 when we were negotiating a new lease. John B. Mallers Jr., trustee and agent of the building and John Johansen, superintendent of the building were present.

Q. What did you say to him and the other parties you speak of, and what did they say?

A. I asked Mr. Mallers for an adjustment on the back rent, which we had been unable to pay, and which accumulated to an amount of over \$15,000. "Well," he says,

28 "I will make an adjustment of this item." He said;

"Go ahead, and sign up the new lease, and so forth, and I will give it a little thought and will let you hear from me."

Q. What was the next conversation, if any?

A. There was not anything more, I didn't hear anything more from him until April, and I went up to see what he had made up his mind to do; and he says, "Well," he says, "pay me \$7,500, and I will call it square, and forget the rest of it."

I said, "Well, I haven't \$7,500."

"Well," he says, "You worry about raising the \$7,500; get busy and raise it and pay it when you can, and forget the rest of it."

Q. Did you raise this \$7,500 and pay it?

A. Yes, sir.

Q. When did you pay it?

A. We paid that in February, \$2,500; in February, 1937, we paid \$2,500; and in April of this same year, \$2,500; and in June of the same year, \$2,500.

Q. Did you have any conversation with him about the adjustment after that conversation in April of 1934?

A. No, I did not.

Q. With reference to those interest items which have been stipulated, did you conduct the negotiations for the reduction of those interest items?

A. I did.

Q. What conversation did you have with Julius Aderer, Incorporated, whom you owed \$10,546.06?

29 A. I went to New York in November of 1936, and pointed out to Julius Aderer the fact that we were not able to charge interest on any of our outstanding accounts; and that we had found that very few, if any, of the other laboratories in the industry had paid interest on their past due accounts; and in view of the fact that we had always made our settlements on the 10th day of the month with notes on anything that we were unable to pay in cash, that I thought we were entitled to an adjustment on that item.

I asked him in the original—I asked at first for the cancellation of all interest that we had paid since the depression started. But it was finally agreed that the interest that was charged from January 1, 1932,—that is when we started losing money in our company, from then on—that the interest item was to be cancelled from then on in full. Julius Aderer told me that they would cancel the whole thing, to forget about it.

Q. Can you state exactly what he said, as nearly as you can?

A. Well, he was very much appreciative and said that they were appreciative of the business we had given him over the term of years, and said that we had been a good customer and he appreciated the business; and he said, "We will cancel the interest after January 1, 1932."

Q. What date was this that this was said, approximately?

A. It was the—it was on a Monday following the November election, so according to the calendar it must have been Monday, the 9th of November.

30 Q. You went down to New York?

A. Yes, sir.

Q. And this conversation was in his office in New York?

A. Yes, sir.

Q. And the year, the year was what year?

A. 1936.

Q. Now, all of this interest which was due was interest on notes which you had given in payment of merchandise?

A. That is right.

Q. What about C. L. Frame, to whom \$5,314.81 was due according to the stipulation? Where was their office?

A. Their office is here in Chicago, 25 East Washington Street.

Q. Who did you see there, and when?

A. Immediately after my return I called on C. L. Frame Dental Supply Company and talked with Clare Frame and Irving Spangler. Frame is the president and Spangler is an officer of the company. I don't know whether he is vice president or what it is.

Q. And what was said by you and Clare Frame?

A. I pointed out to him that Mallers had made an adjustment of the rent item and that Aderer had agreed to cancel all the interest since the 1st of January, 1932; and they agreed to cancel interest the same.

Q. What did they say? State what they said and what you said.

31 A. Clare Frame said that we will cancel our interest on January 1, 1932.

Q. What date, approximately, did this conversation occur?

A. Well, it must have been along about the—I did not stay long in New York at that time; I got what I went after the first day; and I would dare say it must have been about the 11th or 12th of November in 1936.

Q. It was some time in that month?

A. It was right during that week.

Q. What about this Goldsmith Brothers' item of \$1,086.87, mentioned in the stipulation? Where is their office?

A. Their office is at 58 East Washington Street.

Q. Chicago?

A. Yes.

Q. When did you go over there?

A. I left Frame's office and went directly over to Goldsmith's office and talked to Mark Goldsmith, vice president and general manager of the company, and Mr. Adelsdorf.

Q. What was said by you?

A. I stated to them that Mallers had made the adjustment. That Aderer had cancelled or had agreed to cancel the interest; and Frame told me they would cancel the interest. Mark Goldsmith said, "All right, we will cancel the interest from January 1, 1932."

Q. Now, this interest which you owed Frame and Goldsmith was also interest on notes given for merchandise purchased?

A. Yes, sir.

Q. If I understand your testimony on direct examination, you first approached the Mallers Building Company with reference to forgiving the rent in 1933?

A. That is right.

Q. And you came to an agreement some time in 1934?

A. That is right.

Q. But the deal was not consummated until 1937, was it?

A. The deal was consummated in 1934, and the amount was fixed. In 1934 he said, "Well, pay it when you get it."

Q. But he did not say he would forgive the amount of the rent due until you paid the \$7,500, did he?

A. Oh, yes, he did.

Q. You paid him the \$7,500, I believe you said, in February, April and June, 1937?

A. That is right.

Q. And then after you paid him, it was at that time, was it not, that you finally felt that the amount had been forgiven?

A. No, I thought the amount was forgiven, considered it forgiven in 1933. In fact, he proposed earlier in the year that all creditors cut our indebtedness 50 percent. He called me to his office in April, 1933, and wanted me to join him in a fight to ask all creditors for a 50 percent cut of our indebtedness.

We did not enter the forgiveness on our books in 1933. I suppose it was entered in 1937. I didn't pay any attention to the way it was entered on our books or anything like that. We were losing money right along there every year, had not been making any money.

33 At this point the income tax returns of petitioner for 1933 to 1937 inclusive were admitted in evidence as **RESPONDENT'S EXHIBITS A to E inclusive.**

The Witness: I had the conversation with Frame and Aderer in 1936. I recollect it was the Monday following the election in 1936. He said: "We will cancel the interest from January 1, 1932." From that time I understood no further interest was to be credited to the principal account. As to the interest tax returns for 1936 showing the deduction of interest on these accounts will say I didn't pay very much attention to these income tax reports. I admit I signed them but they were made up by our bookkeeper, a Mr. Davis. I don't know why it was deducted when I knew it was going to be cancelled. It is part of the amount that is in the final forgiveness.

The \$25,219.65 we are talking about was deducted on our 1937 return. That is the first time it was entered on our books. That was the first time anyone inspecting our books could find out the indebtedness was forgiven. Of course I am not familiar with the way it was set up on our books.

Q. And these creditors wanted you to pay, what they wanted was to put you in position so that you could pay the balance, in better position to pay the balance?

A. Well, they hadn't so stated, but I would take it that they would, we had been good customers for many, many years.

Q. That is the reason they were willing to forego this interest they had already charged you, isn't that it?

A. I don't necessarily think so. They found they had been charging us interest when they had not been charging other customers interest.

34 Mr. Smith: No further questions.

Redirect Examination.

I did not make the tax returns or keep the books for 1936 and 1937.

HARRY L. DAVIS of 1037 Division Street, Oak Park, a witness for petitioner, being duly sworn, testified as follows:

I am treasurer of the American Dental Company and have been since 1920. The income tax returns for the year 1936 were made under my supervision. I didn't make them out. The books are under my supervision also. I did not participate in the negotiations for the forgiveness of this indebtedness and was not present at them.

Cross-Examination.

I am familiar with how this matter was handled in the books of the company. The books are all here. The entry of the Aderer forgiveness was made December 22, 1937. It was \$10,546.06. It was charged against the amount that was owed the Aderer Company on December 1, there was a balance of \$36,039.96 and after this entry it was \$25,493.90.

Prior to the entry reducing Frame's account we owed \$14,832.23 and at the time of the entry we owed him \$10,594.30. That was the amount that was entered in the tax return for 1937. We owed Goldsmith \$3,566.10 and afterwards we owed \$2,950.16. That also went into the forgiveness of indebtedness for the 1937 return. Prior to making the entry with reference to the Maller's rent 35 our books show we owed them \$15,298.99. We made an entry February 26, 1937, of \$25,000; on April 23, 1937, of \$2500 and on June 25, 1937 of \$2500. These three payments were paid by check. The next entry is February 27th forgiveness item, \$7,798.99. On that basis we owed them nothing, our indebtedness was cleared up.

Redirect Examination.

When I said our indebtedness was paid up I speak of the amount as shown by the books and solely of that.

In explanation of why I made these entries at this time will say in 1934, I knew there was some arrangement made for cancellation of some of the old balance that we owed but did not know the amount. I did not know that amount until April, 1934. Well, I never gave any consideration or thought to its being a taxable item; and for that reason

I didn't make any entries on the account at all until we had paid these different items, and those entries were not made until the end of 1937. I never considered it would be considered income.

Recross Examination.

I didn't know about the arrangement with reference to the \$7500 until April, 1934. I knew there was a settlement made on that basis then. The balance was not entered on the books as forgiveness of indebtedness until several months after the payments were made in 1937, when we closed our books for 1937.

Mr. Hughes: There is one more thing I forgot. Will you stipulate that the petitioner offered to pay the Government in settlement of this amount of taxes, the amount stated by these deductions in prior years?

36 Mr. Smith: If your Honor please, I don't see any pertinency to any such request for such a stipulation.

Mr. Hughes: Subject to the objection—

Mr. Smith: I object to the whole matter, I don't think it is pertinent. The whole matter should be stricken out, what he offered to pay the Government.

The Court: He simply asks you, as I understand it, if it is not a fact that they agreed to do that; but it does not preclude you from objecting to it; but simply that it is a fact.

Mr. Smith: Yes, Mr. Hughes wrote a letter, and he said in that letter—I will read what he says, the last paragraph. The letter is dated November 20, 1940, and is addressed to Mr. Shearer, 1300-Board of Trade Building, Chicago, Illinois, attention of Mr. Jonas M. Smith. The last paragraph reads as follows: "As you know, I offered to settle the case by having my client pay the amount of tax which it is claimed my client saved by the deductions."

The Court: You object to that?

Mr. Smith: I object to that on the ground that it is not pertinent to the issue here at all.

The Court: The record may show the fact. Whether it is pertinent or not is to be argued. The petitioner rests, is that right?

37 MABEL GRANT, a witness for respondent, being duly sworn, testified as follows:

I am the bookkeeper for the Mallers Building Trust. I made the entries in the books which I have here. On January 1, 1937 the books show the American Dental Company owed \$15,306.34.

Q. May I ask you, that was the amount of rental that was to be paid under the lease that you now have, is that right?

A. Well, when we carry an old balance, and we receive money, we always apply it on the old balance, on account of the statute of limitations.

Q. In other words, you applied these on the balance that was due back for prior years?

A. Well, that was the assumption.

Q. That was the assumption?

A. Yes, sir.

Q. Now, then, under your method you made entries against that old balance, is that right?

A. It does not show that way; they are just posted.

I have an entry showing an item of \$7,798.99. I have a posting in March, 1937. I show it in the Journal, page 691, and we credited the American Dental Company with \$7,798.99 and charged that to bad and doubtful accounts "to write off the balance of old account as per agreement."

Cross-Examination.

On January 1, 1934 the sum of \$15,647.89 was owing by the American Dental Co. to Mallers Trust according to its books. All the money which we collected between 1934 and January, 1937, was applied against that account.

38 A new lease was made effective January 1, 1934 which reduced the rent to \$8,000 per year. The \$8,000 was paid in 1934. The same is true for 1935 and 1936.

Mr. Hughes: In other words, what I am trying to get at is this, and I will rephrase it this way.

Q. (By Mr. Hughes.) According to your way of applying payments to the oldest accounts on your books—you testified the American Dental Company owed \$15,000 back rent in January, 1934; also in 1934 and 1935 you took in from them about \$16,000. Now, under your system of

applying payments to the oldest accounts, by the end of 1935 this old balance of \$15,000, which was existing on January 1, 1934, was wiped out so far as your books are concerned?

A. It would amount to the same thing.

I do not know what the negotiations were for the adjustment of the rent. I was not present. It was Mr. Mallers and Mr. Johansen. Mr. Johansen is in the office now. Mr. Mallers died in July, 1934. These negotiations were made before then.

Redirect Examination.

The effect of making the entry of \$7,798.99 was to wipe out the balance due.

Recross Examination.

This is the first time the Mallers Trust has been in the black for six years.

Respondent's exhibit E, being the petitioner's Income Tax Return for 1937, is annexed hereto.

39 The foregoing is all of the material evidence deduced at the hearing of the Board of Tax Appeals and the same is approved by the undersigned as attorneys for petitioner and respondent in review.

(S) John E. Hughes
John E. Hughes
Attorney for petitioner in review.

(S) J. P. Wenchel
J. P. Wenchel
Attorney for Respondent in review.

1937

UNITED STATES DEPARTMENT OF THE TREASURY

CORPORATION INCOME AND PROFITS TAX RETURN

23-

1937

For Calendar Year 1937 or Fiscal Year

beginning 1937, and ended 1938

AMERICAN OPTICAL COMPANY

3 South Adams Avenue

Chicago

Cook

Illinois

Mechanical Dentistry

EXCESS-PROFITS TAX COMPUTATION

Item No.		Rate	Amount of Tax
1. Net income for excess-profits computation (Item 29, Schedule A)	\$ 18,736.39		
2. Share value of capital stock outstanding in year ended with tax return for the year ended June 30, 1937 (or in year capital stock was returned for the year ended June 30, 1938, if year income for that year began in 1937 and ended on or after July 31, 1938)	\$1,000,000.00		
3. Enter here 10 percent of Item 2	\$ 100,000.00		
4. Share value reduced under 40 percent of Schedule 7, column 2	\$ 1,100,000.00	19	
5. Balance subject to excess-profits tax (Item 1 minus Item 3 and 4)	\$ 17,636.39		
6. Amount taxable at 6 percent (5 percent of Item 5, but not more than Item 5)	\$ 881.82	6%	
7. Balance taxable at 10 percent (Item 5 minus Item 6)	\$ 16,754.57	10%	
8. Total excess-profits tax			\$ 1,770.00

NORMAL TAX COMPUTATION

9. Net income for normal tax computation (Item 31, Schedule A)	\$ 18,736.39		
10. Share value reduced under 40 percent of Schedule 7, column 2	\$ 1,100,000.00		
11. Balance subject to normal tax (Item 9 minus Item 10 or 11)	\$ 17,636.39		
12. Tax on portion of Item 11 in excess of \$1,000	\$ 160.00	9%	
13. Tax on portion of Item 12 in excess of \$1,000 and not in excess of \$5,000	\$ 1,430.00	11%	
14. Tax on portion of Item 12 in excess of \$5,000 and not in excess of \$10,000	\$ 428.01	15%	
15. Tax on portion of Item 12 in excess of \$10,000	\$ 2,018.01	15%	
16. Total normal tax in Item 12 to 15			\$ 4,036.01
17. Normal Tax or Combination Tax (See Instructions for Schedule 7, column 2)			
18. Share and trust exemption (see Instruction 11)		15%	
19. Exemption deduction		15%	
20. Corporations entitled to the benefits of section 214 of the Revenue Act of 1936		15%	
21. Corporations organized under the Cross Trade Act, 1933		15%	
22. Foreign corporations engaged in trade or business within the United States or having an office or place of business therein		20%	

UNDISTRIBUTED PROFITS SURTAX COMPUTATION

(The Schedule B reporting corporation except has filed)

23. Net income for surtax tax computation (Item 31, Schedule A)	\$ 18,736.39		
24. Normal tax (Item 17 above)	\$ 4,036.01		
25. Credit for holding company affiliate or national foreign corporation (see Instruction 111 (a) and (b))	\$ 6,018.01		
26. Adjusted net income (Item 23 minus Items 24 and 25)	\$ 16,774.39		
27. Dividends paid credit (Item 18, Schedule B)	\$ None		
28. Credit for contracts requiring dividend payments (see Instruction 111)	\$ None		
29. Undistributed net income (Item 26 minus Items 27 and 28)	\$ 16,774.39		
30. Portion of Item 29 taxable at 7%: \$1,000 or 10% of Item 29, whichever is greater (but not more than Item 29)	\$ 1,000.00	7%	
31. Portion of Item 29 taxable at 12%: 10% of Item 29 (but not more than Item 29 minus Item 30)	\$ 1,527.44	12%	
32. Portion of Item 29 taxable at 17%: 20% of Item 29 (but not more than Item 29 minus Items 30 and 31)	\$ 3,254.88	17%	
33. Portion of Item 29 taxable at 27%: 20% of Item 29 (but not more than Item 29 minus Items 30, 31, and 32)	\$ 3,254.88	27%	
34. Portion of Item 29 taxable at 27%: (Item 29 minus Items 30, 31, and 32)	\$ 3,127.18	27%	
35. Total surtax in Items 30 to 34			\$ 2,663.73
36. Total normal tax and surtax (Item 17 plus Item 35)			\$ 6,699.74
37. Less: Credit for income tax paid in foreign country or possession (see Instruction 17)			
38. Balance of tax (Item 36 minus Item 37)			\$ 6,699.74
39. Excess-profits tax (Item 8 above)			\$ 1,770.00
40. Total tax (Item 38 plus Item 39)			\$ 8,469.74

One from each set - "DUPLICATE COPY" must be filed with this original return (200 will be returned if duplicate set is not made).

Schedule A—NET INCOME COMPUTATION

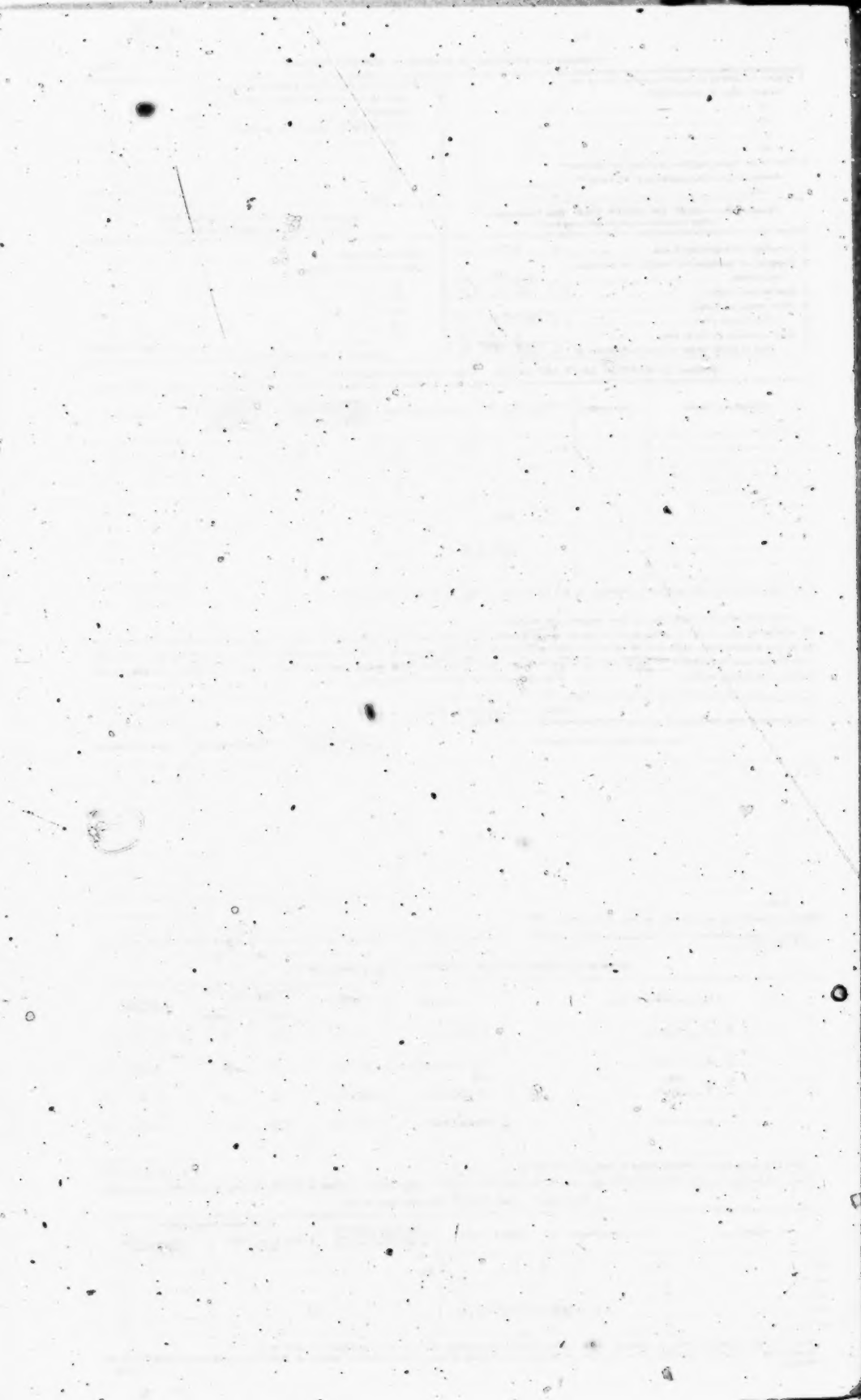
GROSS INCOME			
1. Gross sales (before deductions) on business-determining factor	See Schedule D	3,522.66	3,522.66
2. Less cost of goods sold (from Schedule D-1)		308.83	32
3. Gross profit from sales (from 1 minus 2)		323.83	11
4. Gross receipts (before deductions) on non-business-determining factor		0	
5. Less cost of operations (from Schedule D-2)		0	
6. Gross profit from non-business-determining factor (from 4 minus 5)		0	
7. Interest on loans, notes, mortgages, bonds, bank deposits, etc.		0	
8. Interest on obligations of the United States (from Schedule D, line 10 or 10-1)		0	
9. Dividends		0	
10. Royalties		0	
11. Capital gain or loss (from Schedule D-3. If a net loss, do not enter over \$2,500)		0	
12. Dividends (from Schedule D)		0	
13. Other income (state nature of income)		0	
14. Total amounts from 1, 3, and 6 to 13, inclusive		323.83	12
DEDUCTIONS			
15. Compensation of officers (from Schedule D-4)		28,816	60
16. Salaries and wages and deducted retirement	See Schedule	22,921	23
17. Rent		10,310	61
18. Repairs		0	
19. Bad debts (from Schedule D-5)		4,007	79
20. Interest		306	62
21. Taxes (from Schedule D-6. Do not include Federal income tax)		4,936	14
22. Contributions or gifts (from Schedule D-7)		0	
23. Losses by fire, storm, etc. (Schedule D-8, see Instruction 10)		0	
24. Depreciation (from Schedule D-9)		1,744	15
25. Depletion of minerals, oil and gas wells, timber, etc. (Schedule D-10, see Instruction 11)		0	
26. Other deductions authorized by law (from Schedule D-11)		3,495	64
27. Total deductions (from 15 to 26, inclusive)		48,292	73
28. Net income for business-determining factor (from 3 minus 27)		24,091	39
29. Less Federal income tax paid (from Schedule D-12)		0	
30. Interest on obligations of the United States (from D, sheet 1)		0	
31. Net income for non-business-determining factor (from 6 minus 28 minus 29 minus 30)		24,091	38

Part 2—RECONCILIATION OF NET INCOME AND ANALYSIS OF EARNED SURPLUS AND UNDIVIDED PROFITS

1. Total net income (from Schedule A, line 31) during the taxable year	24,091	39
2. Add or subtract:		
(a) Federal income tax paid on business-determining factor (from Schedule A, line 29)	0	
(b) Federal income tax paid on non-business-determining factor (from Schedule A, line 31)	0	
3. Federal income tax paid on business-determining factor (from Schedule A, line 29)	0	
4. Federal income tax paid on non-business-determining factor (from Schedule A, line 31)	0	
5. Federal income tax paid on business-determining factor (from Schedule A, line 29)	0	
6. Federal income tax paid on non-business-determining factor (from Schedule A, line 31)	0	
7. Federal income tax paid on business-determining factor (from Schedule A, line 29)	0	
8. Federal income tax paid on non-business-determining factor (from Schedule A, line 31)	0	
9. Federal income tax paid on business-determining factor (from Schedule A, line 29)	0	
10. Federal income tax paid on non-business-determining factor (from Schedule A, line 31)	0	
11. Additions to surplus (from Schedule A, line 31)	0	
12. Subtractions from surplus (from Schedule A, line 31)	0	
13. Net surplus (from Schedule A, line 31)	24,091	39
14. Additions to surplus (from Schedule A, line 31)	0	
15. Subtractions from surplus (from Schedule A, line 31)	0	
16. Net surplus (from Schedule A, line 31)	24,091	39
17. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
18. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
19. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
20. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
21. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
22. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
23. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
24. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
25. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
26. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
27. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
28. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
29. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
30. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
31. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
32. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
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37. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
38. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
39. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
40. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
41. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
42. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
43. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
44. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
45. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
46. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
47. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
48. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
49. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
50. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
51. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
52. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
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59. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
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61. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
62. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
63. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
64. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
65. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
66. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
67. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
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71. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
72. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
73. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
74. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
75. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
76. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
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78. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
79. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
80. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
81. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
82. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
83. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
84. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
85. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
86. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
87. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
88. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
89. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
90. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
91. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
92. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
93. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
94. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
95. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
96. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
97. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
98. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39
99. Surplus and undivided profits on business-determining factor (from Schedule A, line 31)	24,091	39
100. Surplus and undivided profits on non-business-determining factor (from Schedule A, line 31)	24,091	39

NOTE.—Attach to this return and mark as Schedule D-1, D-2, etc., schedule of surplus reserves, if any, as shown by the balance sheet (Schedule D), additions to which are not deductible for income and non-business-determining factor purposes.





Modelo L-FAIR (de Interiores 93)

Assets	Liabilities	Assets	Liabilities
Illinois Franchise	99 32	Social Security Title 2	1,196 34
California Franchise	129 02		
Capital Stock Tax	24 00		
Personal Property estimate	254 77		
Social Security Title 9	2,529 45		
		Total Assets on Form 21, Schedule A1	4,975 11

Schedule A—CONTRIBUTIONS OR GIFTS (See Instructions on page 1)

[illegible]

Module 2—DEPRECIATION (See Schedule M)

[illegible]

Module L - OTHER INDUCTIONS (the interesting bit)

See attached schedule

Schedule M.—CONTRIBUTIONS TO STOCKHOLDERS AND DIVIDENDS PAID CREDIT OF INCOME TAXES

Schedule B of Dividends or Profits of the Virginia Water or the Bank of the State of New York for the year ending February 28, 1913		1. Dividend Distribution		2. Dividend Distribution	
1. Cash					
2. Assets other than cash or the corporation's own securities (See notes 1 and 2.) (Include notes of assets.)					
3. Treasury stock. (See notes 1 and 2)					
4. Obligations of the corporation (bonds, notes, etc.). (See notes 3 and 4)					
5. Common stock of the corporation distributed to holders of common stock. (See notes 5 and 6)					
6. Preferred stock of the corporation distributed to holders of common stock. (See notes 3, 4, and 5)					
7. Common stock of the corporation distributed to holders of preferred stock. (See notes 3, 4, and 5)					
8. Preferred stock of the corporation distributed to holders of preferred stock. (See notes 3, 4, and 5)					
9. Optional—Method of payment elected by stockholders					
(a) Cash					
(b) Common stock. (See notes 5 and 6)					
(c) Other. (See note 3.) (Specify nature)					
10. Total of items 1 to 9					
DIVIDENDS PAID CREDIT					
11. Taxable distributions (See 10, column 1)					
12. Dividend carry-over from preceding taxable year (attach schedule of computation)					
13. Dividends paid credit (Total of lines 11 and 12). (Enter on line 27, page 1)					
14. Adjusted net income (from 26, page 1)					
15. Dividend carry-over (See 13 minus line 14)					
RECONCILIATION					
16. Total distributions out of earnings or profits of the taxable year or out of earnings or profits accumulated since February 28, 1913 (Total of columns 1 and 2, line 10)					
17. Total distributions charged to earned surplus and undivided profits, as shown on line 1, Schedule 3					
18. Total distributions during the taxable year exceeding or less than					

It seems the amounts entered on lines 16, 17, and 18 are not the same, despite differences.

• **Wages**

1. Enter the basis of the two following securities determined as of time of distribution: (a) The adjusted basis in the hands of the corporation as provided in section 113 of the Revenue Act of 1939, as amended; or (b) the fair market value.
2. Enter the amount of the fair market value of the securities.
3. Enter the basis of the two following securities as of the time of distribution: (a) Fair value; or (b) fair market value.
4. Preferred stock for this purpose should be separated from stock which is entitled to no dividend or assets, irrespective of formal declaration.
5. Distributions in the form of rights to purchase stock or to subscribe to stock or other obligations of the corporation should be entered in the appropriate line in the assets, debts or other obligations for which rights were distributed.



Schedule B—BALANCE SHEETS (See Instructions 9)

Page 9

	Beginning of Taxable Year			End of Taxable Year		
	Amount	Total		Amount	Total	
ASSETS						
1. Cash		\$ 13,134	79		\$ 666	21
2. Notes receivable	\$ 23,393	97		\$ 19,341	97	
3. Accounts receivable	94,142	99		104,112	95	
(a) Total of items 2 and 3	\$ 117,535	78		\$ 123,453	17	
(b) Less reserve for bad debts	3,362	78		4,680	38	
		114,166	06		118,623	72
4. Inventories						
(a) Raw materials	\$ 6,187	01		\$ 7,237	51	
(b) Work in process						
(c) Finished goods						
(d) Supplies	647	10		911	42	
		6,834	11		8,148	93
5. Investments (Government obligations)						
(a) Obligations of a State, Territory, or political subdivision thereof, or the District of Columbia, or United States government						
(b) Obligations of the United States						
(c) Obligations of instrumentalities of the United States						
6. Other investments						
(a) Stocks of domestic corporations						
(b) Bonds of domestic corporations						
(c) Stocks and bonds of foreign corporations						
(d) Treasury stock						
(e) All other investments or loans						
7. Deferred charges						
(a) Prepaid insurance, taxes, etc.		3,562	48		3,587	06
8. Capital assets						
(a) Buildings						
(b) Machinery and equipment, fixtures	\$ 45,724	30		\$ 48,286	24	
(c) Furniture and fixtures						
(d) Delivery equipment						
(e) Other depreciable assets	Auto	510	00		680	00
(f) Total of items (a) to (e)	\$ 46,234	30		\$ 48,976	24	
(g) Less reserve for depreciation	34,344	91		35,913	93	
(h) Depreciable assets						
(i) Less reserve for depletion						
(j) Land						
9. Other assets (Finance Indenture)						
(a) (See Form 990) Bonds	\$ 15	29				
(b) Goodwill	270,248	24		270,248	24	
		270,263	53		270,248	24
10. Total Assets		\$ 422,060	48		\$ 415,236	41
LIABILITIES AND CAPITAL						
11. Accounts payable		\$ 25,703	27		\$ 3,677	24
12. Bonds, notes, and mortgages payable (with original maturity of less than 1 year)		62,051	12		79,638	36
13. Bonds, notes, and mortgages payable (with original maturity of 1 year or more)						
14. Accrued expenses						
(a) Interest	\$ 200	57				
(b) Taxes	4,928	82		8,264	82	
(c) All others		5,129	39		8,264	26
15. Other liabilities (Finance Indenture)						
16. Surplus reserves (Finance Indenture)						
17. Capital stock						
(a) Preferred stock	\$ 58,900	00		\$ 58,900	00	
(b) Common stock	115,861	93		115,861	93	
18. Paid-in or capital surplus		178,061	93		174,761	93
19. Retained surplus and undivided profits		150,116	26		189,714	06
20. Total Liabilities and Capital		\$ 422,060	48		\$ 415,236	41

Schedule C—CHANGES IN CORPORATION'S OBLIGATIONS AND CAPITAL STOCK (See Instructions 9)

	Obligations	Preferred Stock*	Common Stock
1. Total cash receipts during taxable year from sale of corporation's own interest-bearing obligations with original maturity of 1 year or more and capital stock			
2. Total cash expenditures during taxable year for purchase or retirement of corporation's own interest-bearing obligations with original maturity of 1 year or more and capital stock			
3. Difference between items 1 and 2		3,330 00	
		3,330 00	

* Preferred stock for this purpose should be considered as stock which is preferred as to either dividends or assets, irrespective of formal designation.

[illegible]

January 9, 1930

1 Date of incorporation Delaware

2 State or country Delaware

3 State collector's office where your return for the preceding year was filed Illinois

4 The corporation's books are in care of M. L. Davis, Treasurer
Located at 5 W. Balmain Ave., Chicago, Ill.

5 Is the corporation a personal holding company within the meaning of section 261 of the Revenue Act of 1926, as amended by the Revenue Act of 1927 No. If so, an additional return on Form 1120K must be filed.

6 Is this a consolidated return of railroad corporations? No. If so, prepare from the receiver of internal revenue for your district Form 951, Affidavit Schedule, which shall be signed, sworn to, and filed as a part of this return.

7 If this is not a consolidated return of railroad corporations, and (a) you owned at any time during the taxable year 50 percent or more of the voting stock or enough purchases power to elect or enough of (b) any corporation, individual, partnership, trust or association, owned at any time during the taxable year 50 percent or more of your voting stock, state separately elsewhere showing with respect to each: (1) name and address; (2) percentage of stock owned; (3) date stock was acquired; and (4) the collector's office to which the income tax return of such corporation, individual, partnership, trust, or association for the last taxable year was filed.

8 Was the income of this corporation included in a consolidated return for any prior year? No. If so, give name and address of corporation which filed the consolidated return and the last year for which such return was filed.

9 Was the corporation in any way an outgrowth, result, continuation, or reorganization of a business or businesses or existence during this or any prior year since December 31, 1917? No. If answer is "yes", give name and address of each predecessor business, and the date of the change in entity.

If your work changed, was any asset value increased or decreased? No. If answer is "yes", showing balance sheets of old business and opening balance sheets of new business must be furnished, unless furnished heretofore.

10. Is this return made on the basis of cash receipts and disbursements? No. If not, describe fully what other basis or method was used in computing net income.

Accrued

11. State whether the inventories at the beginning and end of the taxable year were valued at cost, or cost or market, whichever is lower.

Cost If other basis is used, describe fully, state why used, and the date inventory was last reconciled with stock.

December 31, 1927

12. Did the corporation make a return of information on Forms 1050 and 1050a (see instruction 1) for the calendar year 1927? Yes

13. Did the corporation make a return of information on Forms 1050 and 1050a (see instruction 1) for the calendar year 1927? Yes

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself depose and says that this return (including any accompanying schedules and statements) has been examined by him and it, to the best of his knowledge and belief, is a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1935, as amended, and the Revenue Act of 1936 and 1937, and the regulations issued thereunder.

3rd day of March 1938
 Miss [illegible]
 (Please Address Telegrams to 1144 Broadway (New York) (New York)

William H. Schallert, Esq.
 President of National Union of Public Employees
 Harry L. Davis, President
 (Please Address Telegrams to 1144 Broadway (New York) (New York)

COMMUNIST INFLUENCE

I declare (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the income tax and/or excise tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

day of

46 Corporation Income & Excess Profits Tax Return
Calendar Year 1937

American Dental Company

5 South Wabash Avenue

Chicago, Ill.

Deductions

Item 16 Salaries & wages (not deducted elsewhere)

Office Salaries	10,469.78
Errand Salaries	2,243.60
Selling Salaries	3,856.50
Suburban Delivery Salaries	6,351.35

\$22,921.23

47 Corporation Income & Excess Profits Tax Return
Calendar Year 1937

American Dental Company

5 South Wabash Avenue

Chicago, Ill.

Deductions

Item 19 Schedule H

Bad Debts

Percentage of sales ascertained to be worthless	4,477.88
Amount recovered from accounts charged off	470.09

Net amount	4,007.79
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Reserve for bad debts January 1, 1937	3,362.70
---------------------------------------	----------

Increase 1937	4,477.88
---------------	----------

Accounts charged off 1937	7,840.58
	3,190.20

Reserve for bad debts Dec. 31, 1937	4,650.38
-------------------------------------	----------

48 Corporation Income & Excess Profits Tax Return
Calendar Year 1937

American Dental Company

5 South Wabash Avenue

Chicago, Ill.

Deductions

Item 24 Schedule K

Depreciation

Fixed Asset Account		Fixtures & Equipment	
January 1, 1937	Balance		46,234.30
1937	Purchases		2,741.84
			<hr/> 48,976.14
Reserve for depreciation			
January 1, 1937	Balance		34,144.81
1937	Depreciation	Rate 6%	1,769.12
			<hr/> 35,913.93
December 31, 1937	Balance		
	Depreciation		
1937			1,769.12
	Recovered from sale of item depreciated		25.00
			<hr/> 1,744.12

49 Corporation Income & Excess Profits Tax Return
Calendar Year 1937

American Dental Company

5 South Wabash Avenue

Chicago, Ill.

Deductions

Item 26 Schedule L

Other deductions

Errand Expense 697.41

Postage

Inventory January 1, 1937 40.48

Purchases 1,509.98

1,550.46

Inventory December 31, 1937 43.83

1,506.63

Insurance 777.20

Office Supplies

Inventory Jan. 1, 1937 566.14

Purchases 4,236.48

4,802.62

Inventory Dec. 31, 1937 517.71

4,284.91

Selling Expenses 1,742.72

Advertising 4,409.15

Delivery Service City 16,815.07

Delivery Service Suburban 560.45

General Expense

Legal expenses 605.00

Collection fees 270.00

Traveling expenses 275.00

Miscellaneous 752.10

1,902.10

32,695.64

Filed 19
May 7,
1941.

UNITED STATES BOARD OF TAX APPEALS

American Dental Company, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Docket No. 102977. Promulgated May 7, 1941.

Income—Forgiveness of Indebtedness.—Forgiveness of debts for back rent and accrued interest, *held*, to have taken place in the taxable year rather than prior thereto; the forgiveness was not a gift; and the resulting tax liability need not be limited to the tax benefit measured in dollars received by the taxpayer in prior years when it claimed deductions on an accrual method for the rent and interest.

John E. Hughes, Esq., for the petitioner.

Jonas M. Smith, Esq., for the respondent.

The Commissioner determined a deficiency in income tax of \$6,339.77 and a deficiency in excess profits tax of \$404.31 for the calendar year 1937. The issue is whether or not he erred in adding to income \$19,234.21, representing canceled indebtedness.

Findings of Fact.

The petitioner is a corporation engaged in the business of operating a laboratory where it does prosthetic work for the dental profession. It filed its return for the taxable year with the collector of internal revenue for the first district of Illinois.

The petitioner has occupied space in the Mallers Building in Chicago for a number of years. It negotiated a new lease in December 1933, at which time the annual rental was reduced from \$15,200 to \$8,400. There was then due from the petitioner \$15,298.99 in back rent. The president of the petitioner notified the renting agent that the petitioner was unable to pay all of that amount and asked for an adjustment. The renting agent said he would make an adjustment, and, in April 1934, advised the petitioner that he would accept \$7,500 in payment of the back rent and would cancel the rest. The petitioner paid the rent required under the lease after 1933 and paid \$7,500 in addition, in 1937 in discharge of the back rent. The \$7,500 was paid as follows: \$2,500 on February 26, 1937, at which time it also gave two notes each for \$2,500; the one note was paid on April 23, 1937; and the

other note was paid on June 25, 1937. The first time that the petitioner made any entry on its books to record the cancellation of the back rent was on February 27, 1937, at which time it made an entry showing that back rent in the amount of \$7,798.99 had been forgiven.

The petitioner kept its books and made its returns upon an accrual method of accounting. It had regularly accrued its rent on its books and had taken deductions for that rent on its income tax returns. Those deductions had served to offset income in like amounts.

The Mallers Building Trust, which owned the Mallers Building, credited all payments of rent which it received from the petitioner to the rent account of the petitioner in an open account without applying any particular payment to any particular charge of rent. This account continued without change or interruption at all times material hereto. An entry canceling the back rent in the amount of \$7,798.99 was made in that account for the first time in 1937, when the petitioner paid the \$7,500 on account of the back rent. The \$7,798.99 was then charged to bad and doubtful accounts "To write off the balance of the old account as per agreement." There was then, for the first time since 1933, no balance due in the account.

The petitioner, in November 1936, owed several creditors for merchandise which they had furnished the petitioner over a period of prior years. The petitioner had been a good customer of these creditors for many years. It had given its interest-bearing notes for the amount which it owed to each creditor. It went to three of these creditors in November 1936 and asked for cancellation of interest on the notes on the ground that the creditors had made a similar arrangement with their other customers. Three creditors agreed that they would cancel all interest accruing after January 1, 1932. The petitioner claimed a deduction on its income tax return for 1936 for interest due on the notes held by the three creditors above mentioned. The first entry that the petitioner made on its books recording the forgiveness of interest on these notes was made in December 1937, when the following accounts payable were credited with the following amounts representing interest on the notes accruing after January 1, 1932:

Julius Aderer, Inc.	\$10,546.06
C. L. Frame Dental Supply Co.	5,314.81
Goldsmith Brothers	1,086.87

The above amounts had been deducted by the petitioner on its income tax returns of previous years as the interest had accrued. Those deductions had offset income on those prior returns to the extent of \$11,435.22.

21 The petitioner had never made any disclosure on its income tax returns showing that the rent and interest above mentioned had been canceled until its return for 1937. It did not report any of the canceled indebtedness as income on that return or on any other return. The cancellation of the indebtedness is shown for the first time on the return for 1937 under schedule B, "Reconciliation of Net Income and Analysis of Earned Surplus and Undivided Profits", as a credit to earned surplus in the amount of \$25,219.65, explained "Forgiveness of debts."

The Commissioner, in determining the deficiency, held that the forgiveness of indebtedness in the amount of \$25,219.65 represented taxable income for 1937 to the extent that the items represented in that total had served to offset income in prior returns, and upon that theory he included in income for 1937, \$19,234.21, consisting of rent in the amount of \$7,798.99 and interest in the amount of \$11,435.22.

The debts for the rent and for the interest were forgiven in 1937.

Opinion.

Murdock: The petitioner, near the end of his brief, makes what might be construed as an argument that the forgiveness of this rent and this interest was not income. That point has really not been placed in issue in this case, but, in any event, the forgiveness of indebtedness to a solvent debtor is income to the extent that it frees assets of the debtor from claim. *United States v. Kirby Lumber Co.*, 284 U. S. 1; *Lakeland Grocery Co.*, 36 B. T. A. 289. This rule has been applied to the forgiveness of a debt for interest. *Consolidated Gas Co. of Pittsburgh*, 24 B. T. A. 331 and 901; *United States v. Little War Creek Coal Co.*, 104 Fed. (2d) 483; *Helvering v. Jane Holding Co.*, 109 Fed. (2d) 933. There was no contention here that the petitioner was insolvent.

The principal contention of the petitioner is that the forgiveness of the debt for the rent and the forgiveness of the debts for the interest occurred in prior years. It contends that the rent was forgiven in 1934 when John B.

Mallors, Jr., the renting agent of the Mallors Building, told the president of the petitioner to pay him \$7,500 and forget about the rest of the back rent. Although the record contains what might seem to be a verbatim statement of the conversation between the president of the petitioner and Mallors in April 1934, we think that, in fairness to the witness, his statement of the conversation should be regarded as no more than his present recollection of the substance of the 1934 conversation. Counsel for the respondent apparently thought that the witness' statement of the 1934 conversation left ambiguous the question of whether or not the cancellation of the back rent was conditioned upon and was to await the payment of \$7,500.

22 He asked the witness whether or not the forgiveness of the back rent in the amount of \$7,798.99 was conditioned upon the payment of the \$7,500 and the witness replied in the negative. If this were the only evidence in the record, it would justify a finding that the forgiveness took place in 1934, but there is other evidence which, if it stood alone, would lead to the conclusion that the forgiveness took place in 1937 because it was conditioned upon and was to await the payment of the \$7,500. This evidence consists of entries in the books of the petitioner and, particularly, entries in the books of the creditor. Those entries show further that the indebtedness for the back rent was not actually canceled on the books until 1937. Cf. *Walker v. Commissioner*, 88 Fed. (2d) 170; certiorari denied, 302 U. S. 692. There is thus a conflict in the evidence and the Board must decide which evidence is the more reliable. The conversation took place six and one-half years before the hearing and it is possible that the recollection of the witness is not entirely accurate as to the terms of the agreement. We are unwilling on this state of the record to make the finding essential to the petitioner's argument, that the rent was canceled prior to 1937.

The same witness testified that the creditors to whom interest was owed had agreed unqualifiedly, in November 1936, to cancel all interest accruing on the notes after January 1, 1932. Here again, if his testimony stood alone, a finding that the debts were canceled prior to 1937 would be proper. But there is other evidence which casts serious doubt upon the accuracy of his testimony. The petitioner on its return for 1936, filed in March 1937, claimed a deduction for the interest accruing in 1936 on these same notes. The witness had signed that return and had sworn

thereon that he had examined it and found it to be correct. Furthermore, entries on the books of the petitioner recording the cancellation of the interest were made for the first time in closing the books for 1937 and disclosure that the interest and the rent had been forgiven was made for the first time on the return for 1937. The attention of the witness was called, on cross-examination, to the inconsistency of his testimony as to the rent and interest and entries pertaining thereto on the books and returns. He was unable to reconcile the inconsistency or to give any satisfactory explanation thereof. Here again, the record does not justify a finding which would reverse the determination of the Commissioner that the debts were canceled in 1937. The petitioner next contends that the cancellation of the rent and interest items represented gifts. No evidence was introduced to show a donative intent upon the part of any creditor. The evidence indicates, on the contrary, that the creditors acted for purely business reasons and did not forgive the debts for altruistic reasons or out of pure generosity. In none of the four instances was the forgiveness a gift. *Fitch v. Helvering*, 70 Fed. (2d) 583; *Reginald Denny*, 33 B. T. A. 738; *Rufus S. Cole*, 42 B. T. A. 1110; *Haden v. Commissioner*, — Fed. (2d) — (Mar. 19, 1941).

The Commissioner has included in income only that part of the forgiven debts which served to offset income in prior years. Cf. *G. M. Standifer Construction Corporation*, 30 B. T. A. 184; *Helvering v. Jane Holding Co.*, *supra*; *Pittsburgh Brewing Co. v. Commissioner*, 107 Fed. (2d) 155. The petitioner does not claim that a larger amount should be included in income, but he makes a contention in his brief that the tax for 1937 can not exceed the actual tax benefit in dollars which the petitioner realized by deducting these items in prior years. This contention is rejected upon authority of *Central Loan & Investment Co.*, 39 B. T. A. 981, where a similar argument was made by the Commissioner. See also *Estate of William H. Block*, 39 B. T. A. 338, 341, where we said: "When recovery of some other event which is inconsistent with what has been done in the past occurs, adjustment must be made in reporting income for the year in which the change occurs."

Decision will be entered for the respondent.

24

UNITED STATES BOARD OF TAX APPEALS.

Entered
May 7,
1941.

Washington.

American Dental Company,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent. } Docket No. 102977.

DECISION.

Pursuant to the determination of the Board, as set forth in its Findings of Fact and Opinion, promulgated May 7, 1941, it is

Ordered and Decided: That there are deficiencies in income and excess profits taxes in the respective amounts of \$6,339.77 and \$404.31 for the calendar year 1937.

Enter:

(s) J. E. Murdock,
Member.

(Seal)

Entered May 7, 1941.

25 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

Filed
Aug. 1,
1941.

For the Seventh Circuit.

American Dental Company,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent. } B. T. A.
Docket No. 102977.

PETITION FOR REVIEW AND STATEMENT OF
POINTS.

Filed Aug. 1, 1941.

Comes now the above named petitioner by its counsel and hereby petitions that the decision of the Board be reviewed by the Circuit Court of Appeals for the seventh circuit according to law.

Praeceptum for Record.

Venue.

Taxpayer's return was filed with the Collector of Internal Revenue at Chicago, Illinois.

The Board's decision was entered May 7, 1941 and a motion for rehearing was denied June 6, 1941.

Statement of Points.

The Board of Tax Appeals confirmed a deficiency of \$6,339.77 income tax and \$404.31 excess profits tax for the calendar year 1937. This deficiency was imposed on alleged income for debt forgiven. The issues in this case are (1) whether the forgiveness of debt was a gift. (2) Whether said debt was forgiven prior to 1937. (3) Whether the forgiveness of debt constituted "income" as that word is used in the sixteenth amendment to the Constitution and (4) Whether there was any legal forgiveness of debt at all.

Petitioner's points are (1) that the forgiveness of debt was a gift; (2) that it did not constitute income as that word is used in the sixteenth amendment to the Constitution; (3) that if it was income it was not 1937 income and finally (4) if there was no gift there was no forgiveness of debt and the creditors may enforce the debt at any time.

Wm. E. Hughes,
Attorney for Petitioner.

Filed 50 IN THE UNITED STATES CIRCUIT COURT OF APPEALS
AUG. 14, 1941.
• • (Caption—102977) • •

PRAECEPTUM FOR RECORD.

Filed Aug. 14, 1941.

The Clerk will please prepare and transmit to the Circuit Court of Appeals for the seventh Circuit the following:

- (1) All docket entries in the case.
- (2) All pleadings in the case.
- (3) Findings of fact, opinion and decision.
- (4) The petition for review and statement of points.

- (5) The statement of evidence.
- (6) This praecipe.

John E. Hughes,
John E. Hughes,
Attorney for Petitioner.

Service is acknowledged of a copy of the above and foregoing praecipe this 14th day of August, 1941.

J. P. Wenchel,
Attorney for Respondent on Review.

UNITED STATES BOARD OF TAX APPEALS.

Entered
Sept. 23,
1941.

American Dental Company,
Petitioner,

vs.

Commissioner of Internal Revenue,
Respondent.

} Docket No. 102977.

ORDER ENLARGING TIME.

Upon motion of counsel for petitioner, it is

Ordered that the time for transmission and delivery of the record *sur* petition for review of the above-entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit be and it is hereby extended to November 12, 1941.

(Signed) C. R. Arundell,
Member.

Dated: Washington, D. C. September 23, 1941.

Now, Oct. 30, 1941, the foregoing is certified from the record as a true copy.

B. D. Gamble,

B. D. Gamble,

(Seal) *Clerk, U. S. Board of Tax Appeals.*

Clerk's Certificate.

UNITED STATES BOARD OF TAX APPEALS

• • (Caption—102977) • •

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 50, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 30th day of September, 1941.

B. D. Gamble,
Clerk,

(Seal)

United States Board of Tax Appeals.

**UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of the printed record, printed under my supervision and filed on the twenty-fifth day of November, 1941, in the following entitled cause:

Cause No. 7847

AMERICAN DENTAL COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this seventeenth day of July A. D. 1942.

[SEAL]

KENNETH J. CARRICK,
*Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.*

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit held in the City of Chicago and begun on the seventh day of October in the year of our Lord one thousand nine hundred and forty-one and of our Independence the one hundred and sixty-fifth.

7847

AMERICAN DENTAL COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board
of Tax Appeals

And, to wit: On the fifteenth day of May 1942, there was filed in the office of the Clerk of this Court, the opinion of the Court, which said opinion is in the words and figures following, to wit:

In the United States Circuit Court of Appeals
for the Seventh Circuit

No. 7847. October Term, 1941, and April Session, 1942

AMERICAN DENTAL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of
Tax Appeals

May 15, 1942

Before MAJOR, KEENER, and MINTON, Circuit Judges.

MINTON, Circuit Judge. The petitioner has appealed from a decision of the Board of Tax Appeals confirming the Commissioner's determination of a deficiency in petitioner's income tax for 1937. The question we are confronted with at the threshold is whether the cancellation of certain indebtedness owed by the petitioner in the amount of \$19,234.21 constituted taxable income.

In December 1933 petitioner was indebted to its landlord for past-due rent in the sum of \$15,298.99. On December 19, 1933 when petitioner's president and landlord's agent were negotiating a new lease, petitioner's president asked for an adjustment on the past-due rent. The landlord's agent replied:

"Well, I will make an adjustment of this item. Go ahead and sign up the new lease, and so forth, and I will give it a little thought and will let you hear from me."

The new lease, which reduced the annual rent from \$15,200 to \$8,400, was signed. Nothing more was said about adjustment of the past-due rent until April 1934, when petitioner again took it up with the landlord's agent, who said:

"Pay me \$7,500, and I will call it square and forget the rest of it."

The petitioner in 1936 was also indebted to three firms for interest upon past-due accounts for merchandise. In November 1936 petitioner's president secured from these three firms separately adjustments in these past-due accounts, cancelling the interest accrued after January 1932. Petitioner kept its books and made its income tax return upon an accrual basis, and up to 1937 it took deductions for the rent and interest which were allegedly adjusted, as we have indicated. The rent forgiven offset income of \$7,798.99, and the indebtedness for interest forgiven offset income of \$11,435.22. There is no question of wilful misrepresentation or fraudulent intent. The

¹ The Board found: "The petitioner . . . negotiated a new lease in December 1933 at which time the annual rental was reduced from \$15,200 to \$8,400. There was then due from the petitioner \$15,298.99 in back rent. . . . The renting agent said he would make an adjustment, and, in April 1934, advised the petitioner that he would accept \$7,500 in payment of the back rent and would cancel the rest."

Commissioner concedes in his brief that there is no question of estoppel.

In 1937 petitioner paid in three equal installments \$7,500 to its landlord, and in its income tax return for 1937, it acknowledged as a "credit to surplus" the cancelled rent and interest. The Board held that the cancelled rent and the cancelled interest in the sum of \$19,234.21 constituted income taxable to the petitioner in 1937 and were subject to the undistributed profits tax, and upon this basis confirmed the Commissioner's determination of a deficiency.

The Government freely conceded that unless the forgiveness of indebtedness in each of these instances was based upon a consideration, it would amount to a gift, and gifts are not taxable as income to the donee. Article 64 of Regulation 77 promulgated by the Commissioner of Internal Revenue reads as follows:

"* * * If, however, a creditor merely desires to benefit a debtor and without any consideration therefor cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income. * * *

Were these debts cancelled by the creditor for the benefit of the debtor and without consideration? The negotiations for the new lease took place in December 1933, and the lease was then agreed upon and executed. At that time, the taxpayer-petitioner asked for an adjustment of the past-due rent account. The landlord's agent said: "* * * I will make an adjustment of this item. Go ahead, and sign up the new lease, and so forth, and I will give it a little thought and will let you hear from me." That terminated the negotiations at that time. No promise was made as to what the adjustment would be. The matter of debt forgiveness was not agreed upon but was left for future negotiations. If the landlord had said: "If you will make the new lease, I will reduce your indebtedness to \$7,500," the making of the new lease might have constituted consideration for the promise to forgive. But that was not done. The landlord said in substance: "You go ahead and make the new lease and I will think it over and let you know later." It was all left to future negotiations. The future negotiations followed the next April, when the landlord's agent said: "Well, pay me \$7,500 and I will call it square, and forget the rest of it." The petitioner-tenant said: "Well, I haven't \$7,500." The landlord's agent replied: "You worry about raising the \$7,500; get busy and raise it and pay it when you can, and forget the rest of it." In the year 1937, the taxpayer-tenant paid the \$7,500 in three equal installments. There was no consideration to the landlord for the cancellation of the debt. There is no evidence that the landlord, if it had been unyielding, could not have collected the whole of its rent account. This it did not do. It forgave all but \$7,500 of the rent for no consideration whatsoever to the landlord, and merely as a benefit to the debtor.

In the negotiations for a reduction of the indebtedness for interest due, there was no semblance of a consideration. The debtor-taxpayer

went to three of its creditors and said in substance: "We don't get any interest on our past-due accounts. You should not charge us with interest on ours to you." The creditors readily agreed and forgave the debt. The creditors might have expected more business in the future, but the debtor-taxpayer did not promise any. Certainly the creditors' expectation was not consideration. The transaction was a pure cancellation of indebtedness, without any consideration and for the benefit of the debtor.

Since, therefore, there was no consideration for the cancelled debts, and the cancellations inured only to the benefit of the debtor, the amount of the debts as cancelled is a gift from the creditors to the debtor, within the meaning of the Treasury Department's regulations, and the debtor was not required to include it in gross income.

The Board stated in its opinion:

"No evidence was introduced to show a donative intent upon the part of any creditor. The evidence indicates, on the contrary, that the creditors acted for purely business reasons and did not forgive the debts for altruistic reasons or out of pure generosity. In none of the four instances was the forgiveness a gift."

Suppose the creditors did act for purely business reasons. As long as there was no consideration for the cancellation, the intent to give necessarily followed. Evidently the Board confused intent with motive. There is no evidence that the creditors did that which they did not intend to do. The creditors' motives are immaterial. *South Dakota v. North Carolina*, 192 U. S. 286, 310, 24 S. Ct. 269, 48 L. Ed. 448.

Our decision may result in the Government getting no tax, although the taxpayer had benefited by deducting the rent and interest accrued. The taxpayer had offered to pay the Department all the tax it had saved by taking the deductions for accrued rent and interest, but the Commissioner refused and insisted that the entire sum be treated as income for the year 1937. The unfairness of the Government's position is evidenced by taxing this sum of \$19,234.21 as excess profits received in 1937. Of course, the taxpayer never received a nickel it could have distributed as dividends. It received cancellation of debts for services and goods already consumed. How it could have distributed that as a dividend is not apparent. It is not difficult to imagine what would have happened to this debtor-taxpayer if it had inveigled its creditors into cancelling these debts on the basis that the debtor was hard up, and then the debtor had distributed a like amount in dividends!

We therefore hold that the indebtedness was cancelled for the benefit of the debtor and without consideration, and was not taxable. The decision of the Board of Tax Appeals is

Reversed.

A true Copy:

Teste:

*Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.*

And on the same day, to wit: On the fifteenth day of May 1942, the following proceedings were had and entered of record, to wit:

Friday, May 15, 1942

Court met pursuant to adjournment

Before Hon. J. EARL MAYOR, Circuit Judge; Hon. OTTO KERNER, Circuit Judge; Hon. SHERMAN MINTON, Circuit Judge

7847

AMERICAN DENTAL COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the United States Board of Tax Appeals entered in this cause on May 7, 1941, be, and the same is hereby, reversed, and that this cause be, and the same is hereby, remanded to the said Board of Tax Appeals.

And afterwards, to wit: On the ninth day of June 1942, there was filed in the office of the Clerk of this Court, a motion for revision of the opinion, which said motion is in the words and figures following, to wit:

No. 7847

In the United States Circuit Court of Appeals
for the Seventh Circuit

AMERICAN DENTAL COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of Decision of the United States Board of Tax Appeals

Motion for revision of the opinion

Now comes the respondent by his attorney, Samuel O. Clark, Jr., Assistant Attorney General, and respectfully moves the Court to revise the portion of its opinion in the above-entitled case, which reads as follows:

"The Government freely conceded that unless the forgiveness of indebtedness in each of these instances was based upon a consideration,

it would amount to a gift, and gifts are not taxable as income to the donee."

I have discussed this question with Mr. Newton K. Fox, who argued the case for the respondent. He informs me that, while agreeing that a gift is not taxable as income, he did not mean to concede that absence of consideration would be fatal to the Government's basic contention that no gift to the taxpayer was intended. Rather than intending to make a gift, we argued, the creditor had cancelled the indebtedness for business reasons. Since this amount had previously been deducted from gross income though not paid, it was our view that it should be treated as taxable income when the debt was cancelled.

Although the respondent's brief also suggested that there was consideration, the Court is no doubt aware that no concession appears in the brief that consideration was essential. This accords with the position which we have consistently maintained in other Circuits.

In view of the foregoing, it is moved that the Court revise its opinion by deleting the words "The Government freely conceded that," appearing in the fourth paragraph on page two of the printed opinion.

Respectfully submitted,

SAMUEL O. CLARK, Jr.,
Samuel O. Clark, Jr.,
Assistant Attorney General,
Attorney for the Respondent.

Service of a copy of the within motion is acknowledged this 8th day of June 1942.

JAMES O'CALLAGHAN,
Attorney for the Petitioner.
By J. T. LOVOREL.

And afterwards, to wit: On the fifteenth day of June, 1942, the following further proceedings were had and entered of record, to wit:

Monday, June 15, 1942,

Court met pursuant to adjournment

Before Hon. SHERMAN MINTON, Circuit Judge

7847

AMERICAN DENTAL COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review of Decision of the United States Board
of Tax Appeals

It is ordered that the motion of counsel for the respondent for revision of the opinion of this Court filed on May 15, 1942, be, and it is hereby, denied.

United States Circuit Court of Appeals
for the Seventh Circuit

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages contain a true copy of the opinion of this Court filed May 15, 1942, judgment entered thereon May 15, 1942, motion for revision of opinion filed June 9, 1942, and order entered June 15, 1942, denying motion for revision of opinion, in the following entitled cause: Cause No. 7847. American Dental Company, petitioner vs. Commissioner of Internal Revenue, respondent, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this seventeenth day of July A. D. 1942.

[SEAL]

KENNETH J. CARRICK,
*Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.*

Supreme Court of the United States

No. 303, October Term, 1942

Order allowing certiorari

Filed October 12, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.